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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 296

PANHANDLE EASTERN PIPE LINE COMPANY, ILLINOIS NATURAL GAS COMPANY, AND MICHIGAN GAS TRANSMISSION CORPORATION,

Petitioners,

vs.

FEDERAL POWER COMMISSION, CITY OF DETROIT, MICH., COUNTY OF WAYNE, MICH., MICHIGAN CONSOLIDATED GAS COMPANY, AND MICHIGAN PUBLIC SERVICE COMMISSION.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

PETITION FOR REHEARING AND STAY OF MANDATE.

IRA LLOYD BUTTS,
32 Custom House Street,
Providence, Rhode Island.

JOHN S. L. YOST,
135 South LaSalle Street,
Chicago, Illinois.

D. H. CULTON,
Oliver Eakle Building,
Amarillo, Texas.

SAMUEL H. RIGGS,
135 South LaSalle Street,
Chicago, Illinois.

BOOKER, ALLEY & DUNCAN,
50 Broadway,
New York 4, New York,

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On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

PETITION FOR REHEARING AND STAY OF MANDATE.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

PRELIMINARY STATEMENT.

On April 2, 1945, this honorable Court entered judgment in the above entitled cause sustaining the order of the Federal Power Commission complained of herein.

The Court's opinion, while fairly stating certain of petitioner's[1] contentions, makes no reference to other contentions of petitioner which go to the very root of the dispute. Furthermore, the opinion indicates that petitioner has not succeeded in making clear its contention with respect to the Commission's treatment of its revenues from unregulated sales. The Court holds (opinion, p. 5) that "The question is whether a formal allocation was necessary under the exceptional circumstances of this case."

We sincerely believe that, upon a rehearing of this cause, we can convince the Court that petitioner is not insisting upon mere legalism, but is urging that the Commission be required to follow some administrative procedure which will clearly define the line of demarcation between its regulated business and its unregulated business. The order under review here does not do that and results not considered by the Court are obviously unfair.

Petitioner respectfully shows unto the Court that a rehearing of this cause should be granted on the following grounds:

1. In the absence of basic and essential findings, the Court is unable to appraise the effect of the Commission's failure to allocate. Results not considered by the Court are obviously unfair.

2. The "exceptional circumstances of this case" relied upon by the Court to sustain the Commission's failure to allocate are either inferences unsupported by the record

1. For brevity, we refer herein to Panhandle Eastern Pipe Line Company, Illinois Natural Gas Company, and Michigan Gas Transmission Corporation, as "petitioner", Colorado Interstate Gas Company v. Federal Power Commission, et al., No. 379 October term, 1944, as "the Colorado Interstate case", Canadian River Gas Company v. Federal Power Commission, et al., No. 380 October term, 1944, as "the Canadian River case" and Colorado-Wyoming Gas Company v. Federal Power Commission, et al., No. 575 October term, 1944, as "the Colorado-Wyoming case". All page references to the opinions in the above cases are to the pamphlet copies supplied by the Clerk of the Court.

or not exceptional in any sense. None of these so-called exceptional circumstances presents any obstacle to the application by the Commission in petitioner's case of the same method of allocation which it applied to Canadian River Gas Company, Colorado Interstate Gas Company and Colorado-Wyoming Gas Company.

(a) The circumstance that "a witness for petitioner testified at the hearing that under petitioner's allocation of costs the unregulated business has the use of facilities of the company without any charge" is an inference unsupported by the record.

(b) The circumstance that "the company attempts no allocation in the conduct of its business. The business is operated as a unit" is not an exceptional circumstance, but a common practice in the natural gas industry.

(c) The circumstance that one of petitioner's officers testified on cross-examination that "any attempt to allocate return, as between regulated business and unregulated business" is "unrealistic", "theoretical" and "not practical" is not exceptional when considered in the light of the circumstances under which he was testifying and the fact that such officer was not produced by petitioner to testify on allocation.

(d) The statement of the Court that "none of the main transmission line operating and maintenance costs was charged to the direct industrial sales" is inaccurate.

(e) The Court's statement that "all agreed that an allocation on the basis of investment or costs would be impractical" is an inference not supported by the record.

(f) The Court's statement that "all agreed that the fair division was a matter of judgment not mathematics" is an inference not supported by the record.

3. The Court has failed to consider the allocation submitted by the Commission's staff through a witness who was better informed than anyone else on the Commission's method of allocation.

4. The Court has failed to consider the fact that petitioner not only requested the Commission to make a segregation of property as between regulated and unregulated sales, but also requested (submitting detailed proposed findings) the Commission to make an allocation of costs; and that petitioner, in its application for rehearing, urged its objection to the Commission's failure to make such allocation.

5. The holding of the Court that once the use of "a formula is waived or is conceded to be impractical or theoretical", the general effect of what the Commission did may be accepted as an allocation, without specific findings of any kind, is contrary to established principles of law consistently recognized and applied by this Court.

6. The question discussed in the Court's opinion under the heading "Producing and Gathering Facilities" should be re-examined in the Canadian River case, and here.

GROUNDS OF PETITION.

I.

In the Absence of Basic and Essential Findings the Court Is Unable to Appraise the Effect of the Commission's Failure to Allocate. Results Not Considered by the Court Are Obviously Unfair.

In the Colorado-Wyoming case, the Court sets forth the standard for judicial review of an order of the Federal Power Commission as follows (opinion, page 7):

> The review which Congress has provided for these rate orders is limited. Sec. 19(b) says that the "finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." But we must first know what the 'finding' is before we can give it that conclusive weight. *We have repeatedly emphasized the need for clarity and completeness in the basic or essential findings* on which administrative orders rest. * * * Their absence can only clog the administra-

> tive function and add to the delays in rate-making. *We cannot dispense with them* for Congress has provided the standards for judicial review under this Act. * * * The courts cannot perform the function which Congress assigned to them in absence of adequate findings. Nor are they authorized under §19(b) to make findings and substitute them for those of the Commission. (Italics added.)

In the case at bar, however, this standard for judicial review is not applied, although the Commission made no findings of the dollars charged as costs or allowed as earnings with respect to the unregulated sales, and stated in its opinion that it had made no allocation (R. J. 34). The Court stated (opinion, p. 5):

> What the Commission did was to allocate to the interstate wholesale business all of the earnings from the entire business in excess of a 6½ per cent return. Insofar as that procedure allocated to the interstate wholesale business *any earnings from the direct industrial sales in excess of 6½ per cent*, it is said to be justified by the use which the direct industrial business made of the main transmission line and its facilities. If that was unfair, the order must be set aside. If it was fair, no reversible error is shown. (Italics added.)

Under this standard of "unfair" or "fair", a result is approved, the measure of which is so vague and uncertain that it can only be expressed in the language of the Court, italicized in the above quotation, as shown *infra* page 10.

Another result, not considered by the Court, is so grossly unfair as to warrant a rehearing of the cause: The order of the Commission requires a reduction in the gross revenues of petitioner from all sources, but does not permit petitioner to reflect any part of such reduction in a reduction of its unregulated rates. It would appear that, if it is fair to treat the business as one subject to regulation in

its entirety (as the Commission frankly admitted it did, R. I. 34) in determining the amount of gross revenues in excess of a fair return upon all of the business, it is grossly unfair to require, *without further findings*, that such reduction in revenues be reflected only in reduced rates applicable to part of the business; yet, that is exactly what the Commission did.

To comply with the order, petitioner cannot accord to its direct customers any reduction in rates without reducing its gross revenues substantially beyond the amount of reduction ordered by the Commission.

The Court states in its opinion (page 4):

> We agree that the Commission must make a separation of the regulated and unregulated business when it fixes the interstate wholesale rates of a company whose activities embrace both. Otherwise the profits or losses, as the case may be, of the unregulated business would be assigned to the regulated business and the Commission would transgress the jurisdictional lines which Congress wrote into the Act.

Directly in point is the following statement of the Court in the Colorado-Interstate case (opinion, p. 9):

> The cases are presented as if the 6½ per cent allowed by the Commission on the rate base limits the earnings from the whole enterprise to 6½ per cent. That also is not true. The return merely measures the earnings allowed from the regulated business. As we have noted, the excess of earnings which Colorado Interstate makes from direct industrial sales (on the basis of 6½ per cent return) is $131,000 annually.

Here, it is conceded that the 6½ per cent allowed by the Commission on the rate base limits the earnings from the whole enterprise to 6½ per cent. It is apparent that, in order to maintain its earnings at the 6½ per cent return allowed by the Commission, petitioner will be forced to

continue in effect existing rates for direct industrial customers.

If petitioner's business in its entirety is earning $5,094,384 in excess of a 6½ per cent return, what the Commission did with respect to the unregulated business cannot be regarded as fair unless there is a finding, supported by evidence in the record, that the net earnings from the unregulated business do not exceed a specified portion of the 6½ per cent return allocated to the unregulated sales. Such a finding is essential here to support the requirement in the order of the Commission that all of the reduction must be reflected in the regulated rates, but that finding is lacking. Furthermore, such a finding would be contrary to the facts in this record. The Court states in its opinion (p. 9) that the earnings derived from these rates to direct customers show "an apparent profit of more than 200 per cent." The only evidence in the record on the subject is the evidence presented by the Commission's staff through its witness Shattuck and the evidence presented by petitioner. There is no support for such a finding in any of this evidence, but, if such a finding could be made, it must still be compared with an unknown quantity, namely, what part of the return allowed on the entire business is properly allocable to the unregulated business.

The difficulty presented here arises out of the fundamental error of the Commission in failing to find the exact amount of earnings and costs attributable to the wholesale business and to make an allocation as between the regulated sales and the unregulated sales. Had this been done, a proper and fair order could have been framed, requiring a reduction, not in the gross revenues of the company, but in the revenues derived from the regulated sales, and requiring that this reduction be reflected in a reduction of the rates subject to the jurisdiction of the Commission.

Petitioner is not asking to be reheard merely to insist on adherence to ritual. It is seeking to have its unregulated business recognized as such and to have the expenses chargeable thereto defined with some degree of certitude.

Examined from a realistic point of view, the Court's statement that "What the Commission did was to allocate to the interstate wholesale business all of the earnings from the entire business in excess of a 6½ per cent return" (opinion, p. 5) does not meet petitioner's contention that the Commission treated the business as subject to regulation in its entirety and did not observe the statutory limitations upon its jurisdiction. Under either the test of "fairness" or the test of "end result" the Court's use of the word "allocate" (in spite of the Commission's frank statement that it did not "allocate", R. I, 34) does not place a different aspect on what the Commission did. Obviously, what the Commission did was to disregard the statutory limitation upon its jurisdiction.

The Commission did not, as the Court holds (opinion, p. 8) use "its informed judgment instead" of "a formula." Its action in treating the business as one subject to regulation in its entirety reflects a refusal to exercise its informed judgment within the jurisdictional limits of the Act.

The record before the Commission contains all facts and figures required for either a separation of property or an allocation of costs as between the regulated sales and the unregulated sales. In addition to the evidence on allocation offered by petitioner, the Commission's witness Shattuck prepared, in accordance with the Commission's method of allocation, discussed and approved by this Court in the Colorado Interstate case, and presented (R. XVI 6883) an allocation complete in every respect except for the one

item of cost which depended on the rate base and rate of return to be fixed by the Commission, namely, an allocation of the return allowed.[2]

A proper exercise of "informed judgment" would require that the Commission adopt or modify one of the two allocations offered, or, in any event, make complete and adequate findings showing the amount of revenue derived from the regulated business and *the amount of reduction therein* to be reflected in reduced regulated rates. It requires no "informed judgment" to treat both the regulated and the unregulated business as subject to regulation.

A statute so rigid in its procedural requirements as applied to the regulated company (particularly those of section 19(b) invoked against petitioner here), can hardly be so flexible in its jurisdictional requirements as applied to the administrative agency, where the right to retain substantial revenues is involved. While the amount of money impounded under the order of the Circuit Court of Appeals (stated by Government counsel in the course of oral argument to be nearly $17,000,000 but now nearer $20,000,000), will go primarily to the United States treasury in the form of excess profits taxes if the order is set aside and, if it is sustained, may reach ultimate consumers only in part (in view of the decision of this Court in *Central States Electric Company* v. *City of Muscatine*, ... U. S. ... No. 85, Oct. Term 1944) the stockholders of petitioner should not be deprived of their comparatively small share in this fund by administrative procedure which disregards statutory limtations or is lacking in essential findings.

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2. In the Colorado Interstate case (opinion, p. 3) the Court quotes the Commission as follows:

> All that can be accomplished by an allocation of physical properties can be attained by allocating costs including the return. The latter method is by far the most practical and businesslike.

No more glaring instance of a lack of "basic and essential findings" can be found in any reported case. If this case is "exceptional" in any respect, it is certainly so in that regard. In the Colorado-Wyoming case the Court reversed in part the judgment below because of defects in a finding of the Commission with respect to allocation. The Court said (opinion, p. 5):

> When we read that finding against the record there are ambiguities which we are unable to resolve were it our province to do so.

Here, by reason of the lack of the basic and essential administrative findings, the Court expresses its view of what the Commission did (opinion, p. 5), but is unable to state the measure of its effect or "end-result" except in the following language: "insofar as that procedure allocated to the interstate wholesale business any earnings from the direct industrial sales in excess of 6½ per cent * * *." This is, patently, an unknown quantity.

The question immediately arises: *6½ per cent of what?* Treating the business as subject to regulation in its entirety, the Commission found that 6½ per cent on its rate base would yield a fair return. There was no separation of property as between the regulated business and the unregulated business, and there was no allocation of the return allowed. Consequently, it is impossible to determine from the Commission's opinion and findings just what were the "earnings from the direct industrial sales in excess of 6½ per cent." It is thus apparent that, by reason of the lack of "the basic or essential findings", it is impossible for the Court (except by making these essential findings itself, which, the Court holds, it cannot do) to determine whether what the Commission did was fair or unfair. We submit that the Court's holding (opinion, p. 9) that "the Commission did not exceed the limits of its discre-

tion when it allocated to the regulated business all excess earnings of the entire business over 6½ per cent" should be reconsidered.

II.

The "Exceptional Circumstances of This Case" Relied Upon by the Court to Sustain the Commission's Failure to Allocate Are Either Inferences Unsupported by the Record or Not Exceptional in Any Sense. None of These So-Called Exceptional Circumstances Presents Any Obstacle to the Application by the Commission in Petitioner's Case of the Same Method of Allocation Which It Applied to Canadian River Gas Company, Colorado Interstate Gas Company and Colorado-Wyoming Gas Company.

The Court's opinion indicates that "a formal allocation" would be required were it not for what the Court regards as "the exceptional circumstances of this case." The Court states (opinion, p. 5):

> The question is whether a formal allocation was necessary under the exceptional circumstances of this case.

While we suggest that the introduction of such an exception to established principles of law applicable to judicial review of administrative action is of such far-reaching effect and public importance as to warrant reconsideration, our purpose here is to convince the Court that the circumstances of this case regarded as exceptional by the Court are either inferences which cannot fairly be drawn from the record or are not exceptional in any sense.

Presentation of this ground of our petition necessarily requires a discussion of the facts. We shall, however, observe the brevity required in a petition for rehearing.

(a) The Court's statement (opinion, p. 5) that "A witness for petitioner testified at the hearing that under peti-

tioner's allocation of costs the unregulated business has the use of facilities of the company without any charge" is an inference which cannot fairly be drawn from the witness' testimony.

Biddison, the witness testifying, was an independent consulting engineer employed by petitioner to value its properties and to testify with respect thereto. He also prepared and testified with respect to Exhibit 251, which was introduced, not as representing a complete allocation "under petitioner's allocation of costs", as the Court infers, but as showing an allocation of only the costs directly attributable to each class of business under his interpretation of the Commission's opinion in the Colorado-Wyoming case. The complete allocation suggested by Biddison is set forth with record references at pages 30 to 34 of petitioners' brief and is tabulated on page 34 thereof. By reference thereto, it will be seen that a substantial and fair charge against the unregulated business was made for the use of facilities of the company used jointly by the regulated and unregulated business.

(b) The circumstance that the company operates its business as a unit and attempts no allocation in the conduct of its business is not exceptional in any sense.

Petitioner kept its books in accordance with the usual practice and custom of the industry. In no case that has come to petitioner's attention has a natural gas company maintained accounts reflecting an allocation of property and expense as between regulated and unregulated business. The Commission's opinion in the Canadian River, Colorado Interstate and Colorado-Wyoming cases (43 P. U. R. (N. S.) 205), indicates that the records of those companies did not reflect any such separation. The Commission said (p. 232):

> Nowhere in the entire evidence submitted by Canadian and Colorado Companies is there a complete presentation of the entire operations of the company broken down between jurisdictional and nonjurisdictional operations.

Moreover, petitioner's books are kept in accordance with the Uniform System of Accounts prescribed by the Federal Power Commission, which does not require such separation. Neither the Commission's staff nor petitioner's witness Biddison experienced any difficulty by reason of the manner in which petitioner's books were kept in making an allocation of costs.

(c) The circumstance that one of petitioner's officers testified on cross-examination that "any attempt to allocate return, as between regulated business and unregulated business" is "unrealistic", "theoretical" and "not practical" is not exceptional when considered in the light of the circumstances under which he was testifying and the fact that such officer was not produced by petitioner to testify on allocation.

That witness testified on direct examination with respect to operating problems in connection with proposed increases in capacity (R. VIII, 3933-3959). He gave no testimony on direct examination as to what would be a proper allocation; he was not produced by petitioner as a witness qualified to testify on that question. On cross-examination, he was interrogated briefly with respect to allocation of "return." He expressed his judgment that any attempt to allocate *return* was unrealistic, theoretical and not practical, but made no statement that it was impossible or impractical to make an allocation of petitioner's earnings as between the two classes of business. Believing, as did witness Biddison, that an attempt to "allocate return" was

not the appropriate way to allocate earnings, he said (R. XVIII, 3960) in commenting on the Commission's opinion in the Colorado cases:

> The idea of taking two classes of business and trying to divide, as is tried in this proration. I can't see how it is possible to not recognize both classes of business, when each business contributes something to the other. Now, unfortunately, that isn't apparently the position that some members of this Commission had in mind, but nevertheless it is my opinion. I think each one contributes something to the other, and that should be recognized.

The remarks of petitioner's officer were made before Commission's witness Shattuck testified and presented his exhibit, and he spoke without the benefit of the Commission's interpretation of its opinion in the Colorado-Wyoming case.

(d) The statement of the Court that "none of the main transmission line operating and maintenance costs were charged to the direct industrial sales" is inaccurate. The Court's reference is to the cost allocation reflected in Exhibit 251. It is shown at page 3, line 33 of that exhibit (R. XIII, 5951) that, of the total transmission and maintenance expense, amounting to $2,130,708, the sum of $165,259 was allocated against unregulated sales. This total sum of $2,130,708 includes items aggregating in excess of $1,000,000 which were allocated between regulated sales and unregulated sales on a volume basis with 86.8 per cent charged to regulated sales and 13.2 per cent charged to unregulated sales (lines 7, 11, 18, 28, 31 and 32 of page 3 of Exhibit 251).

(e) The Court's statement that "all agreed that an allocation on the basis of investment or cost would be impractical" is an inference not supported by the record. On the contrary, all agreed that it was possible to allocate on the basis of investment and also that an allocation on the basis

of costs was practical. Both Biddison and Shattuck did allocate on a basis of costs. The only difference between Biddison and Shattuck lay in Biddison's suggestion that $500,414 be contributed to depreciation and "return", as compared with Shattuck's allocation of depreciation and his adherence to the Commission's formula requiring an allocation of *return as an item of costs.* Shattuck stated that he could not compute the allocation of return until the rate base and rate of return were established (R. VIII, 4002). Biddison's "contribution" method could be applied regardless of the amount of the return. The results reached, respectively, by application of the two methods may be compared by reference to the computations appearing on pages 34 and 35 of petitioner's brief.

The Shattuck method shows $330,558 earned from the unregulated sales in excess of the 6½ per cent return after allocation; application of the Biddison method shows a comparable figure of $319,656. These figures are identical in nature with the item of $54,000 with respect to Canadian River Gas Company and the item of $131,000 with respect to Colorado Interstate Gas Company, appearing in the Court's tabulation at the bottom of page 4 of its opinion in those cases, and also with the item of $40,000 in the Colorado-Wyoming case (the difference between the sum of $159,000 and the sum of $119,000 mentioned in the Court's opinion in that case at the top of page 2).

(f) The Court's statement that "all agreed that a fair division was a matter of judgment not mathematics" is an inference not supported by the record. The two witnesses produced as experts on allocation used a combination of judgment and mathematics according to the respective principles adopted by each. All of Biddison's allocations of costs, as such, were made according to engineering principles and mathematics (R. VIII, 3656-3657). The one element in his method of allocation which he said was a matter

for the Commission's judgment and did not depend upon engineering principles was the amount of "contribution" to depreciation and return (R. VIII, 3872-3873). Shattuck's judgment was controlled by the method applied by the Commission in the Canadian River, Colorado Interstate and Colorado-Wyoming cases.

Petitioner took the position in its brief, and maintains here, that it was the duty of the Commission to examine this evidence and make findings with respect thereto. *Nowhere in the Commission's opinion or findings is either of the allocations suggested by these witnesses discussed or even mentioned.*

III.

The Court Has Failed to Consider the Allocation Submitted by the Commission's Staff Through a Witness Who Was Better Informed Than Anyone Else on the Commission's Method of Allocation.

The Court's opinion appears to proceed on the theory that the only evidence on allocation before the Commission was that presented by petitioner through its witness Biddison. The Court has failed to consider the complete allocation submitted by the Commission's staff through its witness Shattuck, who was better informed than anyone else on the Commission's method of allocation with respect to natural gas companies, which was revealed for the first time in the Commission's opinion and order in the Canadian River, Colorado Interstate and Colorado-Wyoming cases. That opinion and order were released March 18, 1942, a few weeks before the evidence of Biddison on allocation was introduced by petitioner. Petitioner's counsel and the witness Biddison advised the Examiner and Commission counsel in open hearing that they had been unable to understand the Commission's explanation of its treatment of demand costs in the Colorado-Wyoming case. In response, counsel for the Commission said (R. VIII, 3671):

> Of course, you will have that in greatest detail and in practical application very shortly.

Subsequently, the testimony of Shattuck and his detailed exhibit on allocation were introduced by the Commission's staff (R. VIII, 3991-4002; R. XVI, 6883-6887).

The purpose of the proceedings was to determine whether petitioner's rates were just and reasonable. Petitioner was entitled to have the evidence of Shattuck considered by the Commission and is entitled to have it considered by the Court in determining whether the Commission has performed its statutory duty.

IV.

The Court Has Failed to Consider the Fact That Petitioner Not Only Requested the Commission to Make a Segregation of Property As Between Regulated and Unregulated Sales, But Also Requested (submitting Detailed Proposed Findings) the Commission to Make an Allocation of Costs; and That Petitioner, in Its Application for Rehearing, Urged Its Objection to the Commission's Failure to Make Such Allocation.

In its opinion (p. 7) the Court points to the circumstance that petitioner requested the Commission to find that it had built no capacity for its direct industrial sales and that it was reasonable to allocate 50 per cent of the net earnings from unregulated sales as a credit to net earnings from regulated sales as compensation for the temporary use of such facilities provided for regulated sales but used from time to time in transporting the gas for direct interruptible unregulated sales, when not required for regulated sales, and continues

> But it does not appear that Petitioner requested the Commission to make a segregation of the properties used in the two classes of business.

The Court's reference is to paragraph 21 of "Proposed Findings of Fact" forming part of petitioner's opening brief before the Commission. That brief is not in the printed record. It is not even a part of the record certified by the Commission to the court below. Inasmuch, however, as the Court has quoted from one of petitioner's requested findings, it is not inappropriate that petitioner call to the Court's attention other requested findings of fact by which petitioner sought not only an allocation of properties but also appropriate allocations of costs.

In Finding No. 22, petitioner requested the Commission to find that a proper allocation of petitioner's gas plant as between regulated sales and unregulated sales resulted in a reduction of the prudent investment rate base by $591,727, of which $515,527 represented the depreciated portion of the investment applicable to unregulated sales and $76,200 represented the allocable portion of $1,500,000 working capital.

Petitioner also requested allocations of expenses. In Finding No. 23, it requested the Commission to find that, of the annual operating and maintenance expenses, $413,321 should be allocated to unregulated sales; in Finding No. 24, that, of the depreciation, depletion, and amortization charges, $34,404 should be allocated to unregulated sales; in Finding No. 25, that ad valorem and certain other taxes should be allocated in the sum of $51,972 to unregulated sales; and in Finding No. 26, that, of the income and excess profits taxes, $197,350 should be allocated to unregulated business.

In Finding No. 27, petitioner requested the Commission to find that, on the basis of 1941 consolidated revenues, $1,500,527 should be allocated to unregulated sales and that a credit of $500,414 representing a charge against the unregulated sales of one-half of the profits resultant from

said sales would increase the total revenues from, and allocable to, regulated sales to $16,789,459.

Thus, in the proposed findings of fact filed with the Commission before its order was entered, petitioner made an appropriate request to the Commission for findings both as to an allocation of property and as to an allocation of costs and earnings. The Commission should have disposed of those requests by making appropriate findings. It did not.

The Court observes in its opinion (p. 7) that, in the petition to the Commission for rehearing, petitioner did not complain of the Commission's failure to allocate properties, but merely complained of the Commission's action in taking the proceeds of direct industrial sales into consideration in determining the amount of petitioner's profits and in ordering the rate reduction; and in failing reasonably to allocate petitioner's earnings between regulated sales and unregulated sales. It is said "that precludes an attack in the courts on the Commission's order for failure to make a segregation of properties."

But petitioners have attacked the Commission's order because of *its failure to make an allocation of any kind* as between the regulated and unregulated business. The attack is made on the ground that the effect of the Commission's order is to assign profits from the unregulated business to the regulated business and, in the language of the Court (opinion, pp. 4-5), to "transgress the jurisdictional lines which Congress wrote into the Act." That is what the Commission has done in this case and petitioner's objection thereto was fully preserved in its petition for rehearing.

The proposed findings of fact filed with the Commission by petitioner included findings dealing with both an allocation of property and an allocation of costs. At the time

the petition for rehearing was prepared, however, petitioner was persuaded that, as the Commission had held in the Colorado cases (and as this Court has expressly held in reviewing those cases), it is not necessary, in order to allocate earnings, to make an allocation of property, but that a satisfactory result can be arrived at through an allocation of costs.

It is obvious that an allocation of earnings requires both a determination and allocation of receipts and a determination and allocation of appropriate charges against those receipts. Petitioner's objection to the Commission's failure to allocate was urged in the petition for rehearing in specifications 33 and 34 (R. XVI, 7147) which read as follows:

> XXXIII
>
> The Commission erred in assuming jurisdiction of respondents' direct sales by taking the proceeds from such sales into consideration in determining the amounts of respondents' profits, and then directing that the excess return so determined be reduced through a reduction of the prices and charges for gas sold for resale.
>
> XXXIV
>
> The Commission erred in failing reasonably to allocate respondents' earnings between regulated sales and unregulated sales.

By these specifications, petitioner brought notice to the Commission that it was complaining of the Commission's action in treating its business as subject to regulation in its entirety, thus, assigning profits from the unregulated business to the regulated business.

V.

The Holding of the Court that, Once the Use of "A Formula Is Waived or Is Conceded to Be Impractical or Theoretical," the General Effect of What the Commission Did May Be Accepted As an Allocation, Without Specific Findings of Any Kind, Is Contrary to Established Principles of Law Consistently Recognized and Applied by This Court.

In this case and in the Colorado Interstate, Canadian River, and Colorado-Wyoming cases, the Court has held that it is the statutory duty of the Commission to make an allocation of the earnings of a natural gas company between the regulated and nonregulated business and to limit its rate-making activities to that part of the business which is by statute made subject to its jurisdiction. In performing its statutory duty in this regard, it is essential that the Commission make specific findings as to the portion of the expenses of operation to be borne by the unregulated business and the portion of the earnings from that business that should be allocated to "the return" as an item of costs or contributed to the regulated business for the use of the jointly used facilities. Such findings, it is admitted, the Commission did not make.

The holding of the Court that, once the use of "a formula is waived or is conceded to be impractical or theoretical", the general effect of what the Commission did may be accepted as an allocation, without specific findings of any kind, is contrary to established principles of law consistently recognized and applied by this Court. It is in direct conflict with the principles announced and applied in the Colorado-Wyoming case.

This Court has repeatedly held that an order of an administrative tribunal which exceeds its statutory authority

or lacks an essential basic finding which will permit the Court to determine whether or not the statutory standards have been applied is void.[3]

As shown *supra* pages 8-11, any statement of the general effect of what the Commission did merely serves to emphasize the fact, admitted by the Commission (R. I, 34), that it made no allocation but treated the business as subject to regulation in its entirety.

The Natural Gas Act does not invest the Commission with authority to determine under what circumstances it will or will not assume jurisdiction over direct sales of natural gas companies. Such a grant of authority would be invalid as an attempt to delegate legislative powers in the absence of standards prescribing the occasion for, and the manner of, its exercise.[4] The Natural Gas Act does not provide such standards.

The objection that the Commission has exceeded its statutory powers is fundamental and goes to the jurisdiction of the Commission over the subject matter. This jurisdiction cannot be conferred either by waiver or by express consent.[5]

In *Beaumont, S. L. & W. Ry* v. *United States*, 282 U. S. 74, this Court held that a division of joint rates by the

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3. *Florida* v. *United States*, 282 U. S. 194; *United States* v. *Baltimore & Ohio R. R. Co.*, 293 U. S. 454; *Arizona Grocery Co.* v. *Santa Fé R. R.*, 284 U. S. 370; *Texas & Pacific Ry. Co.* v. *United States*, 289 U. S. 629; *United States* v. *Carolina Freight Carriers Corp.*, 315 U. S. 475; *Chicago Junction Cases*, 264 U. S. 258; *Wichita R. & L. Co.* v. *Public Utilities Commission of Kansas*, 260 U. S. 48.

4. *Panama Refining Company* v. *Ryan*, 293 U. S. 388; *A. L. A. Schechter Poultry Corp. et al.* v. *United States*, 295 U. S. 495.

5. *United States* v. *Griffin*, 303 U. S. 226; *Florida* v. *United States*, 282 U. S. 194; *United States* v. *American Ry. Express*, 265 U. S. 425; *Inter Mountain Rate Cases*, 234 U. S. 476; *Tap Line Cases*, 234 U. S. 1; *Beaumont, S. L. & W. Ry.* v. *United States*, 282 U. S. 74; *United States, et al.* v. *Corrick, et al.*, 298 U. S. 435; *Skinner & Eddy Corp.* v. *United States*, 249 U. S. 557.

Interstate Commerce Commission based upon evidence on a group basis and the use of averages was invalid even though the carriers had not objected to the method used by the Commission and had presented evidence on that basis. The Court said, page 87:

> And the Commission is not excused by the fact that the carriers presented evidence on a group basis or by the omission of the southwestern lines in their petition for a rehearing to object to the use of averages. The proceedings before the Commission were for the determination of what divisions are and for the future will be reasonable. Here the issue is whether the Commission's amended determinations and the order based on them are valid. Appellants are not estopped from assailing the averages or groups adopted. A sound basis for the rule or formula prescribing the divisions is essential to compliance with the Act.

In *United States, et al.* v. *Corrick, et al.*, 298 U. S. 426, the Court said, page 440:

> The appellants did not raise the question of jurisdiction at the hearing below. But the lack of jurisdiction of a federal court touching the subject matter of the litigation cannot be waived by the parties, and the district court should, therefore, have declined *sua sponte*, to proceed in the cause. And if the record discloses that the lower court was without jurisdiction this court will notice the defect, although the parties make no contention concerning it.

In *Skinner & Eddy Corporation* v. *United States*, 249 U. S. 557, the Court said, page 562:

> The contention is that the Commission has exceeded its statutory powers; and that, hence, the order is void. In such a case the courts have jurisdiction of suits to enjoin the enforcement of the order, even if the plaintiff has not attempted to secure redress in a proceeding before the Commission.

We submit that the failure of the Commission to limit the exercise of its powers to petitioner's wholesale business presents a question of the jurisdiction of the Commission over the subject matter, which petitioner could not waive either expressly or by implication.

VI.

The Question Discussed in the Court's Opinion Under the Heading "Producing and Gathering Facilities" Should Be Reexamined in the Canadian River Case and Here.

Under the heading "Producing and Gathering Facilities" the Court discusses petitioner's objection to the Commission's treatment of its producing and gathering properties in determining the amount of petitioner's gross revenues available for rate reduction. The Court holds (opinion, p. 10) that (1) this phase of the case is controlled by the Canadian River case and (2) petitioner is precluded by section 19(b) of the Act from attacking the order on this ground.

For the reasons set forth in the petition for rehearing filed by Canadian River Gas Company and by the Independent Natural Gas Association of America, Amicus Curiae, in the Canadian River case, we think the Commission's treatment of production and gathering properties in this case, as well as that, should be reconsidered.

Petitioner is barred from having the issue re-examined here unless it can convince the Court that it is not precluded from raising the issue by section 19(b) of the Act. This question was not fully briefed and argued before the

Court[6] and is of such public importance in the judicial review of orders of the Commission under the Natural Gas Act that it should be reconsidered and a determination thereof made only with the benefit of full argument.

We submit that petitioner is not so precluded because (a) the application for rehearing before the Commission fairly presented to the Commission petitioner's objection to the treatment of its production and gathering facilities and (b) the question, being one of jurisdiction, can be raised at any time in the course of the proceedings.

(a) *The application for rehearing before the Commission fairly presented to the Commission petitioner's objection to the treatment of its production and gathering facilities.*

We recognize that the soundness of petitioner's contention that it preserved its objection to the Commission's treatment of its production and gathering facilities depends on the construction of section 19(b) of the Act. If the provisions of that section are construed so strictly that no argument in support of an objection to the order can be made in the reviewing court unless such supporting argument appears in the application to the Commission for rehearing, then, petitioner must admit that its arguments here were not presented in its application for rehearing.

6. It appears in the brief for respondents only as a passing remark on page 31 with a short reference note, and was answered in petitioner's reply brief at page 9 with a short statement pointing out that it was a question of jurisdiction and could be raised at any time but that, nevertheless, the objection had been preserved in substance in the petition for rehearing filed with the Commission. By reason of the enlargement of the scope of review herein, respondents were unable to serve their brief within the time limited by the rules of this Court, and it did not reach petitioner's counsel until late in the afternoon of the Wednesday preceding Monday, January 29, the day the case was argued. Consequently, in order to have its reply brief printed and filed within the time limited by the rules of Court, petitioners had little more than twenty-four hours for its preparation, with the result that points raised by the respondents could be answered only briefly and without supporting argument and citation of authorities.

We do not think, however, that the provisions of section 19(b) should be so construed; we think that such was not the intent of Congress. The purpose of the section appears to be to give the administrative agency an opportunity to reconsider its order before judicial review and to prevent the Commission from being taken by surprise in the reviewing court by an objection to its procedure or determinations of which it did not have fair notice. The provision that even such an objection may be considered by the Court if "there is reasonable ground for failure" to urge it in the application for rehearing indicates that it was not the intent of Congress that the regulated company should suffer an injustice by reason of a strict construction of the limitation on the scope of review.

Here, the Commission can be presumed to have been aware of the limitation on its jurisdiction expressly set forth in section 1(b) of the Act providing that the provisions of the Act should not apply to the production or gathering of natural gas. In the course of the hearing, the question of valuation of the producing and gathering facilities arose. After extended argument before the Commission's Examiner, the Examiner ruled (R. I, 718; VIII 3974) that the valuation of all properties of petitioner, including its producing and gathering properties, should be based on evidence of original cost, and refused to permit petitioner to introduce evidence showing the present value of its gas leasehold estates. The Commission, in its opinion, approved the ruling of the Examiner (R. I, 18-21) and, for the purposes of its order, treated petitioner's business as subject to regulation in its entirety, valuing all of petitioner's property at original cost.

We think that petitioner's specification of error number II fairly placed the Commission on notice that peti-

tioner sought a rehearing for the purpose of fully arguing in all aspects, both factual and legal, results flowing from the refusal of the Examiner to admit petitioner's evidence of the present value of its gas leasehold estates.[7]

Mr. Justice Jackson, in his concurring opinion in the Canadian River case recognizes that production and gathering of natural gas are excluded from the jurisdiction of the Commission, but holds that the Commission may *value* such properties for the purpose of fixing the rates for interstate sales subject to the jurisdiction of the Commission. He holds, however, that valuation of natural gas producing properties at original cost has no rational basis. That is precisely the position of petitioner, with the added contention that such method of valuation, even if otherwise lawful, may not be applied to petitioner's unregulated properties and business.

Petitioner's position before the Commission was that, if its production and gathering facilities were included in the rate base, their valuation should be consistent with their status as unregulated properties. On the application for rehearing, this position was preserved, in that, petitioner's specification number II thereof was directed to the action of the Examiner, approved by the Commission, in refusing to admit petitioner's evidence of the present value of its leasehold estates.

7. This specification of error (R. XVI, 7142) reads as follows:

The Examiner for the Commission erred in refusing to admit in evidence the present value of the gas leasehold estates owned by Respondent Panhandle Eastern, based on the prices at which said gas leaseholds could now be sold, whether the production therefrom be sold by the purchaser in a regulated or in an unregulated market. The details of such valuation and the testimony of the witness Wallace explanatory thereof fully appear in Exhibits 37 and 37A, objections to the admission of which were sustained by the Examiner, and subsequent tender of proof thereon rejected.

(b) *The question, being one of jurisdiction, can be raised at any time in the course of the proceedings.*

The Court's opinion recognizes in its discussion of the challenge made by the City of Cleveland, as Amicus Curiae, to the jurisdiction of the court below over the subject matter of this litigation, that a question of jurisdiction can be raised at any time. The question presented here is recognized, discussed and decided by the Court as a question of jurisdiction in the Canadian River case. It is a fundamental principle that, where Congress has withheld jurisdiction, it cannot be conferred or exercised by waiver, concession, or other act of the parties.

Unless the pertinent provision of section 19(b) of the Act be regarded as a qualification of the jurisdictional limitations set forth in section 1(b) thereof, it would appear that a contention directed to the jurisdiction of the Commission under the Act would not be an objection to an order within the pertinent language of section 19(b). It seems to us that the type of objection which cannot be raised on review unless urged in the application for rehearing includes only objections directed to administrative action of the Commission exercised within the ambit of its authority.

The purpose of Congress in delimiting the jurisdiction of the Commission would be defeated if the power of the reviewing court to notice and set aside an exercise of jurisdiction on the part of the Commission expressly withheld by the statute were denied simply because, through design or oversight, no objection to the Commission's action in such regard was made in the application for rehearing. We submit that the decision in the Canadian River case should be reconsidered, and petitioner should have an opportunity to fully brief and argue here the question of whether the provisions of section 19(b) preclude petitioner from a reconsideration of the question as applied

Prayer.

Wherefore, petitioner prays that a rehearing be granted herein for the purpose of reconsidering the issues presented and the judgment entered and that, pending the Court's consideration of this petition, and until a ruling is made thereupon, the mandate to the court below be stayed, and the time for issuance thereof be enlarged.

Respectfully submitted,

IRA LLOYD LETTS,
32 Custom House Street,
Providence, Rhode Island.

JOHN S. L. YOST,
135 South LaSalle Street,
Chicago, Illinois.

D. H. CULTON,
Oliver-Eakle Building,
Amarillo, Texas.

SAMUEL H. RIGGS,
135 South LaSalle Street,
Chicago, Illinois.

BOOKER, ALLEY & DUNCAN,
50 Broadway,
New York 4, New York,
Of Counsel.

Certificate of Counsel.

I, John S. L. Yost, being of counsel herein, do hereby certify that the foregoing petition for rehearing and for a stay of the mandate herein is presented in good faith and not for delay.

....., John S. L. Yost,
Attorney for Petitioner.

SUPREME COURT OF THE UNITED STATES.

No. 296.—October Term, 1944.

Panhandle Eastern Pipe Line Company, Illinois Natural Gas Company and Michigan Gas Transmission Corporation, Petitioners, *vs.* Federal Power Commission, City of Detroit, County of Wayne, Michigan, et al.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[April 2, 1945.]

Mr. Justice Douglas delivered the opinion of the Court.

Panhandle Eastern Pipe Line Co. (whom we will call Panhandle Eastern) owns properties which constitute a natural gas production, transportation, and marketing system.[1] The system extends from gas fields in Texas, Oklahoma and Kansas through Missouri, Illinois, Indiana and Ohio and into Michigan.[2] The City of Detroit and the County of Wayne, Michigan, filed a complaint with the Federal Power Commission alleging that Panhandle Eastern's rates on gas sold to a distributing company in Michigan for resale there were unjust and unreasonable. The Commission on its own motion instituted an investigation under the Natural Gas Act of 1938, 52 Stat. 821, 15 U. S. C. § 717, of all of the interstate wholesale rates of Panhandle Eastern.[3] Following extended hearings the Commission entered an interim order, here under review, finding petitioner's interstate wholesale rates to be excessive and requiring petitioner to reduce them on and after November 1, 1942, as to reflect, when applied to petitioner's 1941 transportation and sales a reduction of not less

[1] The other petitioners, Illinois Natural Gas Co. and Michigan Gas Transmission Corp., were wholly owned subsidiaries of Panhandle Eastern. They sold all of their properties to Panhandle Eastern after these proceedings were instituted and were then dissolved. Accordingly, we will refer throughout to the three companies as "petitioner".

[2] The Commission found that the aggregate lines in this system constitute "the longest natural-gas pipe line in the world, serving more than 200 cities, towns, and communities with more than 700,000 retail customers in Texas, Kansas, Missouri, Illinois, Indiana, Michigan, and Ohio." 45 P. U. R. (N. S.) 203, 208.

[3] The investigation also included Illinois Natural Gas Co. and Michigan Gas Transmission Corp. See note 1, *supra*.

than $5,094,384 per annum below the 1941 consolidated gross operating revenues of $17,789,573. See 45 P. U. R. (N. S.) 203, 223. That order was affirmed by the Circuit Court of Appeals for the Eighth Circuit, one judge dissenting in part. 143 F. 2d 488. The case is here on a petition for a writ of certiorari which we granted limited to the two questions which we will discuss. But before we reach them we must dispose of a challenge made by the City of Cleveland, as *amicus curiae*, to the jurisdiction of the Circuit Court of Appeals for the Eighth Circuit over the subject matter of this litigation. Panhandle Eastern sought review in that court of the Commission's order under § 19(b) of the Act which so far as material here provides:

> "Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia . . . ."

The petition for review stated that petitioner had its principal place of business in Kansas City, Missouri. That was not denied by the Commission and at no time prior to the entry of the judgment affirming the Commission's order was the jurisdiction of the Circuit Court of Appeals challenged. After the judgment of affirmance had been entered, however, the City of Cleveland filed a motion in the Circuit Court of Appeals for leave to intervene and challenged the jurisdiction of that court on the ground that petitioner did not have its principal place of business in that circuit. The same objection is pressed here.

If the objection is to the jurisdiction of the court, it does not come too late. *Industrial Addition Assoc.* v. *Commissioner*, 323 U. S. 310. But we think it goes to venue not to jurisdiction. We read § 19(b) to invest all intermediate federal courts with the power to review orders of the Commission, provided, however, that if a Circuit Court of Appeals, rather than the Court of Appeals for the District of Columbia, is chosen, the parties may object that the particular circuit lacks the specified qualifications. Venue relates to the convenience of litigants. *Neirbo Co.* v. *Bethlehem Corp.*, 308 U. S. 165. The provisions of § 19(b) plainly are of that character. Review in the Court of Appeals for the District of Columbia where the Commission must maintain its principal office and hold its general sessions (46 Stat. 797, 16 U. S. C. § 792) is convenient for the Commission. Review in any circuit where the

natural gas company is located or has its principal place of business is designed to serve the convenience of the company. The general grant of authority in § 19(b) to all the courts of appeal suggest that the question of which one should exercise the power in a particular case is a question of venue. None of the respondents objected at any time to the venue of the court below. The right to have a case heard in the court of proper venue may be lost unless seasonably asserted. *Industrial Addition Assoc.* v. *Commissioner, supra.* It may be waived by any party, including the government. *Peoria By. Co.* v. *United States,* 263 U. S. 528, 535-536; *Industrial Addition Assoc.* v. *Commissioner, supra.* The objection of the City of Cleveland which came after judgment had been rendered came too late. Cf. *United States* v. *Californina Canneries,* 279 U. S. 553, 556. Hence, we need not decide whether the suit was brought in the proper circuit.

Segregation of the Regulated and Unregulated Businesses. Panhandle Eastern makes direct industrial sales as well as sales to distributing companies for resale. The Commission made no segregation or separation of the properties used in these two classes of business. Nor did it make an allocation of costs between the regulated and unregulated phases of the business as it did in *Colorado Interstate Gas Co.* v. *Federal Power Commission, Canadian River Gas Co.* v. *Federal Power Commission,* and *Colorado-Wyoming Gas Co.* v. *Federal Power Commission,* decided this day. The reasons which the Commission advanced for its failure to make any allocation are so crucial to the disposition of the case that we quote from the opinion:

> "Upon the record before us, we consider it unnecessary to make an allocation of the respondents' business as between sales for resale and direct sales. The direct sales are made to nineteen industrial customers on an interruptible basis and at prices fixed in competition with other fuels.
>
> "According to respondents' own evidence, no capacity has ever been constructed or provided in their gas plant for these direct industrial customers. It is equally clear that deliveries are made to them only when there is available excess off-peak capacity not required by the other wholesale customers. As evidence of this fact, in 1941 the volume of gas sold to the direct industrial customers amounted to 13.2 per cent of the total system sales, whereas on the system peak day of the 1941-1942 winter the direct industrial sales constituted only 2.69 per cent of the total deliveries, due to interruptions and curtailments brought about by the necessity for meeting the wholesale customer requirements.

"Testimony of respondents' witnesses discloses that only $128,848 of the entire investment in plant (less than one-sixth of one per cent) is used exclusively in the service of the direct industrials. Moreover, the respondents themselves treat their entire business as a unit and make no segregation of costs or profits on their books as between the two classes of sales. Indeed, Panhandle Eastern's president testified quite clearly on cross-examination that any attempt to allocate would be 'theoretical,' 'unrealistic,' and 'not practical' because of the unified character of the business.

"Deliveries to the direct industrials are made only when the plant is not fully used in serving the requirements of the wholesale business, and are curtailed or interrupted when the capacity is required by the wholesale customers. It is apparent that the incidental direct industrial business is in reality a by-product of the wholesale business, comparable to the respondents' gasoline extraction business. All parties are agreed that the expenses and revenues in connection with the sale of gasoline extracted from the natural gas should be treated as an integral part of the respondents' entire operations. Thus, it is manifest from the evidence that the direct industrial sales are purely incidental to the main or principal enterprise, viz.: the wholesale business of the respondents." 45 P. U. R. (N. S.) p. 218.

Petitioner contends that these reasons do not justify the failure of the Commission to make a formal allocation either of the property or the costs between the regulated and unregulated business. It says that the direct sales are beyond the jurisdiction of the Commission even though they are comparatively small. It asserts that the fact that the direct sales are on an interruptible basis merely emphasizes the relatively small amount of the cost of construction and operation attributable to such sales. It says that no waiver of the statutory right to have the direct sales free from regulation can be inferred and that in any event the Commission's jurisdiction cannot be enlarged by waiver. And it contends that the Commission's finding that the direct industrial business is "in reality a by-product of the wholesale business" is not supported in reason or in fact.

We agree that the Commission must make a separation of the regulated and unregulated business when it fixes the interstate wholesale rates of a company whose activities embrace both. Otherwise the profits or losses, as the case may be, of the unregulated business would be assigned to the regulated business and the Commission would transgress the jurisdictional lines which

Congress wrote into the Act.[4] The Commission recognizes this necessity. As it stated in *Re Cities Service Gas Co.*, 50 P. U. R. (N. S.) '65, 89: "The company's facilities and operations are devoted in part to natural gas service which is not subject to our jurisdiction. This service consists principally of gas sales made directly to large industrial consumers. The necessity arises, therefore, for making an allocation of costs as between the jurisdictional and non-jurisdictional sales." The question is whether a formal allocation was necessary under the exceptional circumstances of this case.

We state the question that narrowly because the dispute in this case reflects not a rejection by the Commission of the principle of allocation but a disagreement over the propriety of the procedure followed here.

What the Commission did was to allocate to the interstate wholesale business all of the earnings from the entire business in excess of a 6½ per cent return. Insofar as that procedure allocated to the interstate wholesale business any earnings from the direct industrial sales in excess of 6½ per cent, it is said to be justified by the use which the direct industrial business made of the main transmission line and its facilities. If that was unfair, the order must be set aside. If it was fair, no reversible error is shown.

A witness for petitioner testified at the hearing that under petitioner's allocation of costs the unregulated business has the use of facilities of the company without any charge. He testified that there should be a charge against the unregulated business for the use of that property. Another witness for petitioner stated that the company did not make any allocation between the regulated and unregulated business—"that is, allocation of jointly-used assets"—in determining what would be charged to the unregulated sales. He stated, "It may be heresy to say so but we try to charge our nonregulated customers all the traffic will bear." It was conceded that the company attempts no allocation in the conduct of its business. The business is operated as a unit. And one of petitioner's officers testified:

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[4] Sec. 1(b) provides:

"The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

"Q. That is, any attempt to allocate return, as between regulated business and unregulated business: is that what you meant was unrealistic?

"A. That is correct * * * * If you are going to allocate it theoretically you should allocate it on the basis of the investment and the expenses incident to each part of the business.

"Q. But it is theoretical?

"A. That is correct.

"Q. And not practical?

"A. That is what I am trying to say."

Petitioner presented evidence showing that in the test year 91.57 per cent of its total revenues, or $16,289,045, was received from its wholesale sales and 8.43 per cent, or $1,500,527, was received from its direct industrial sales. It presented a study showing total operating expenses of about $7,900,000 (not including federal income taxes and return) and assigning $499,699 to the direct industrial sales. Thus an apparent profit of $1,000,828 before income taxes was shown for the direct industrial sales. But that study did not allocate any of the annual depreciation expense of the main transmission line ($2,238,589) to the direct industrial sales. Of the $633,270 ad valorem taxes on transmission lines, only $1,738 applicable to the laterals used exclusively for direct industrial sales were allocated to them. None of the main transmission line operating and maintenance costs was charged to the direct industrial sales.

Petitioner recognized the unfairness of attributing to the direct industrial sales all of the apparent profit of $1,000,828. One of petitioner's witnesses testified:

"Q. Is there any engineering basis for a division, from an engineering standpoint?

"A. Not as an engineering matter. I do not know of any basis. As a business matter, I think there are ways in which it could be fairly decided. I think it requires some judgment based upon business experience to make a fair allocation of it but there is a little over a million dollars, some portion of which could, in all fairness, be set aside as a charge against operations on the non-regulated sales and a credit against operations on the regulated sales."

He went on to indicate what he thought a fair allocation would be:

"A. It is my opinion that that $1,000,828.98 should be divided fifty-fifty.

"Q. Why?

"A. It is just my judgment as a businessman that would be a fair allocation of it.

"Q. You mean fifty-fifty as between regulated and non-regulated business?

"A. That is correct. I think that would be a fair allocation.

"Q. That is a business judgment estimate, not a mathematical estimate?

"A. That is right. In that way, this non-regulated business has contributed half a million dollars a year towards the reduction in cost of the regulated business and if it does not contribute something, I do not think there is any justification for having the business."

Petitioner requested the Commission to find that it had built no capacity for its direct industrial sales which were "incremental" in nature and that it was reasonable to allocate "50 per cent of the net earnings from nonregulated sales as a credit to net earnings from regulated sales, as compensation for the temporary use of such facilities provided for regulated sales but used from time to time in transporting the gas for direct, interruptible, nonregulated sales when not required for regulated sales." But

included in the petition for rehearing", the following: Petitioner asserts that it also requested the Commission to make a segregation of the properties used in the two classes of business. No such request, however, was included in the petition for rehearing."

Commission erred (1) in taking the proceeds from the direct industrial sales into consideration in determining the amount of its profits and in ordering the rate reduction; and (2) in failing reasonably to allocate petitioner's earnings between regulated sales and unregulated sales. That precludes an attack in the courts on the Commission's order for failure to make a segregation of property. For § 19(b) of the Act provides that "No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do." No such excuse has been tendered.

On these facts we cannot say that the Commission transgressed the jurisdictional requirements of the Act when it failed to make a formal allocation of costs or of property. All agreed that an allocation on the basis of investment or costs would be impractical. All agreed that some division of the apparent profit from the direct industrial business had to be made. All agreed that the fair division was a matter of judgment not mathematics. In view of those concessions by petitioner, the manner in which it conducted its business, its failure to insist on a segregation of property

in its petition for rehearing, and its own failure to keep accounts which reflected a segregation of the properties or an allocation of costs among the two classes of business, we do not think it can now be asserted that the Commission erred in forsaking a formula and using its informed judgment instead.

We do not mean to imply that such concessions would warrant a departure of the Commission from the statutory scheme of regulation. The issue is a much narrower one. The Commission did not undertake to fix industrial rates. The Commission, as was its duty, merely determined what earnings were properly allocable to the unregulated business. Petitioner disagrees with the result. The use of a formula for an allocation of costs or a segregation of property might or might not have been more favorable to petitioner. But once the use of such a formula is waived or is conceded to be impractical or theoretical, there must be some discretion in the Commission to make that determination through the exercise of its informed judgment. We cannot say that the Commission abused its discretion by conceding on the basis of the special circumstances here presented that earnings of the entire business in excess of a 6½ per cent return should be allocated to the interstate wholesale business. The small investment in the direct industrial business, the incremental nature of it, the extent of the interruptions in service to the direct industrial customers, the manner in which the management has treated it afford a basis for the refusal of the Commission to credit it with a larger share of the earnings than 6½ per cent.

The Commission, while it lacks authority to fix rates for direct industrial sales, may take those rates into consideration when it fixes the rates for interstate wholesale sales which are subject to its jurisdiction. For § 5(a) provides that whenever the Commission "shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, *or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential*, the Commission shall determine the just and reasonable rate". (Italics added) It is clear that contracts covering direct industrial sales come within that italicized clause of § 5(a).[5] The

[5] There must be filed with the Commission not only schedules of rates subject to the jurisdiction of the Commission but "the classifications, practices, and regulations affecting such rates and charges, together with all

industrial rates in force here produce revenues of $1,500,527 with expenses of $499,699 which, according to petitioner, result in earnings of $1,000,828 before income taxes. That is an apparent profit of more than 200 per cent. It is a fairly obvious indication that the regulated business is being saddled with costs which in fairness should be borne by direct industrial sales. That is an extremely relevant consideration for the Commission to take into account when it determines what costs are fairly attributable to each business and what the resultant rate for the wholesale business should be. Sec. 5(a) does not of course give the Commission authority to disregard the jurisdictional lines which Congress has drawn between interstate wholesale sales and direct industrial sales so as to level the profits between the two classes of business. But § 5(a) reinforces our conclusion that in the exceptional circumstances of this case the Commission did not exceed the limits of its discretion when it allocated to the regulated business all excess earnings of the entire business over 6½ per cent.

Producing and Gathering Facilities. The Commission constructed a rate base on the actual legitimate cost of petitioner's property in service on December 31, 1941, which it found to be $78,814,292. It deducted $12,596,987 for accrued depreciation, depletion and amortization. It added $920,000 for working capital. The result was a rate base of $67,137,305 on which the Commission allowed a return of 6½ per cent which it found to be "fair and liberal". It included in the rate base petitioner's producing properties[6] and gathering facilities. Petitioner claims that was error. It contends that it was incumbent on the Commission to determine the field price or actual field value of natural gas in the areas in which petitioner produces gas, to eliminate petitioner's leaseholds and producing and gathering facilities from the rate base, to disallow expenses of gathering and production, and to allow petitioner as an expense item the field price or actual field value for all gas produced by it and taken into the pipe line system. Evidence was offered to show what the market price or actual field value of the gas was. The argument is that the procedure followed by the Commission extends its jurisdiction

contracts which in any manner affect or relate to such rates, charges, classifications, and services." Sec. 4(c). By Rule 54.30 the Commission requires the filing with it of all contracts for direct industrial sales involving sales in excess of 100,000 Mcf per year. See 8 Fed. Reg. 16101.

[6] Petitioner produces approximately 50 per cent of the gas which it transports and sells, the remainder being purchased. The payments for gas purchased were allowed by the Commission as an operating expense.

over "the production or gathering of natural gas" contrary to the mandate of § 1(b).[7] Petitioner suggests moreover that if its leaseholds are to be included in the rate base they should not be included at cost but at what petitioner claims to be the market value.[8]

This phase of the case is controlled by *Canadian River Gas Co.* v. *Federal Power Commission, supra.* We need not repeat what we said there. It is clear that the value of producing properties and gathering facilities is affected whenever rates are fixed. That is inevitably true whether the leaseholds are put into the rate base or whether as petitioner urges the gas is valued as a commodity. That result is not avoided unless Congress puts a floor under production properties and gathering facilities of natural gas companies and fixes a minimum return on them. That Congress has not done. As Judge Sanborn aptly stated in the opinion of the Circuit Court of Appeals: "If there is an infirmity in the Commission's determination of the amount which should be included in the rate base as the cost or value of such facilities, we think the infirmity arises from the method used in making the valuation, and not from any lack of jurisdiction." 143 F. 2d 495. Petitioner, moreover, failed to object in its application for rehearing before the Commission to the inclusion of its producing properties and gathering facilities in the rate base. It is accordingly precluded by § 19(b) of the Act from attacking the order of the Commission on the ground that they are included.

Federal Power Commission v. *Hope Natural Gas Co.*, 320 U. S. 591, holds that the Commission is not bound to use any single formula for the fixing of rates. It is not precluded from using actual legitimate cost as it did here. The question on review is not the method of valuation which was used but the end result obtained since the issue is whether the rate fixed is "just and reasonable." § 5. In the present case the 6½ per cent return allowed by the Commission will permit petitioner to earn $4,363,925 annually on the basis of the test year after meeting all operating expenses which include depreciation, exploratory and development costs, and federal income taxes. The cost of servicing petitioner's long-term debt is $957,786 or 2.88 per cent. The cost of meeting the requirements of the preferred stock is $939,000 or 5.8 per cent. That leaves $2,467,139 for $20,184,175 of common

[7] See note 4, *supra*.

[8] The market value is alleged to be about $8,400,000 as compared with some $955,000 which the Commission found to be the actual legitimate cost.

stock—a return of 12 per cent. The return would be 9 per cent figured on the basis of common stock and surplus of $27,650,000. We are unable to say on these undisputed facts that the return is not commensurate with the risks, that confidence in petitioner's financial integrity has been impaired, or that petitioner's ability to attract capital, to maintain its credit, and to operate successfully and efficiently has been impeded.[9] See *Federal Power Commission* v. *Hope Natural Gas Co.*, *supra*, p. 603.

Affirmed.

Mr. Chief Justice STONE, concurring.

Mr. Justice ROBERTS, Mr. Justice REED, Mr. Justice FRANKFURTER and I concur for the following reasons only.

Petitioners did not raise objections in their application for rehearing to the Commission to the inclusion of their producing and gathering facilities in the rate base. By § 19(b) of the Natural Gas Act "No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing, unless there is reasonable ground for failure so to do." No reason appears for the failure of petitioners here to make objection on rehearing to the inclusion of the production and gathering facilities in the rate base.

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[9] The Commission stated on this phase of the case:

"The evidence discloses that the respondents' business is exceptionally free from serious business hazards. The gas supply is assured for at least thirty to thirty-five more years. We have made ample provision in the annual depreciation allowance for the restoration of the capital investment in the property over the claimed life of the gas supply. The respondents' markets are rapidly expanding and embrace the large metropolitan area of Detroit, which alone takes 40 per cent of the entire output under a long-term contract. Panhandle Eastern's president testified that the demand for service is so great that within the next year the respondents will be called upon to sell every cubic foot of gas that can possibly be delivered through the lines, and that the capacity factor will increase from 70 per cent to 90 per cent.

"It is likewise apparent from respondents' own evidence that Panhandle Eastern has been able to raise considerable capital at low cost. Only recently it successfully completed a financing program at remarkably low rates which resulted in a substantial reduction in its annual cost of capital. In February, 1941, Panhandle Eastern sold $18,250,000 of first mortgage and first lien bonds and $5,000,000 of serial notes at an average annual interest cost of 2.74 per cent. In February, 1942, it sold an additional $10,000,000 of first mortgage bonds at an interest cost of 3.13 per cent and $15,000,000 of preferred stock at a cost of 5.86 per cent. After the financing, Panhandle Eastern's annual cost of long-term debt was 2.88 per cent and preferred stock was 5.87 per cent, a combined annual cost of only 3.85 per cent for these securities.

"Panhandle Eastern has earned an average of 10.64 per cent on its net investment over the past five years, and Michigan Gas an average of 8.5 per cent during approximately the same period." 45 P. U. R. (N. S.) p. 215.